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In the Supreme Court of the United States

OCTOBER TERM, 1961

No. 83

HATTIEBELLE O. SIMONSON, TRUSTEE IN BANKRUPTCY OF THE ESTATE OF MAX L. DRUXMAN, BANKRUPT, PETITIONER

v.

R. C. GRANQUIST, DISTRICT DIRECTOR OF THE INTERNAL REVENUE SERVICE

RICHARD D. HARRIS, TRUSTEE FOR ALASKA TELEPHONE CORPORATION, PETITIONER

v.

UNITED STATES OF AMERICA

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENTS

OPINIONS BELOW

The opinion of the court of appeals in *Simonson* v. *Granquist* (S.R. 33–36) [1] is reported at 287 F. 2d 489. The opinion of the court of appeals in *Harris* v.

[1] "S.R." refers to the portion of the record pertaining to *Simonson* v. *Granquist;* "H.R." refers to the portion of the record pertaining to *Harris* v. *United States.*

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United States (H.R. 65–66) is reported at 287 F. 2d 491.

The referee's findings and conclusions in *Simonson* (S.R. 7–21) are not officially reported, and the district court wrote no opinion. The referee's opinion in *Harris* (H.R. 33–37) and his findings of fact and conclusions of law (H.R. 38–45) are not officially reported; the district court in *Harris* wrote no opinion, and its order adopting and modifying in part the order of the referee (H.R. 54–57) is not officially reported.

JURISDICTION

The judgment of the court of appeals in *Simonson* was entered on February 1, 1961 (S.R. 37). A petition for rehearing was filed on March 2, 1961, and was denied on March 13, 1961 (S.R. 37). The judgment of the court of appeals in *Harris* was entered on February 1, 1961 (H.R. 66). A petition for rehearing was filed on March 7, 1961, and was denied on March 13, 1961 (H.R. 67). A consolidated petition for a writ of certiorari for both cases was filed on April 22, 1961, and was granted on June 5, 1961 (H.R. 67; 366 U.S. 943). The jurisdiction of this Court is invoked under Section 24a of the Bankruptcy Act and 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. In *Simonson* v. *Granquist* and *Harris* v. *United States:*

Whether an addition to a federal tax imposed as a penalty by statute, which became a secured claim against the property of the taxpayer and for which

a lien arose prior to the filing of a petition in bankruptcy or reorganization, is properly allowable as a secured claim against the debtor's estate, or is to be disallowed under the terms of Section 57j of the Bankruptcy Act.

2. In *Simonson* v. *Granquist:*

Whether, by virtue of Section 70c of the Bankruptcy Act, a trustee in bankruptcy is a "judgment creditor" within the meaning of Section 6323(a) of the Internal Revenue Code of 1954, so that a federal tax lien is not valid against him, if notice of the lien is not filed until after bankruptcy.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and of the Bankruptcy Act, as amended, are set forth in the Appendix, *infra,* pp. 42–48.[2]

STATEMENT

Simonson v. *Granquist*

Upon liquidation of the business assets of the bankrupt, Max L. Druxman, a retail jeweler, the trustee was able to realize more than $8,000, which was suffi-

[2] The taxes and penalties in *Simonson* v. *Granquist* were imposed under the Internal Revenue Code of 1954, and the tax liens in that case arose under the 1954 Code. The taxes and penalties in *Harris* v. *United States* were imposed under the Internal Revenue Code of 1939, and the tax liens in that case arose under the 1939 Code, namely Sections 3670, 3671 and 3672. These provisions are similar to Sections 6321, 6322 and 6323 of the 1954 Code, which are set forth in the Appendix, *infra,* pp. 42–43.

cient to pay all tax claims and expenses of administration (S.R. 7).

The District Director of Internal Revenue filed various claims in the bankruptcy proceeding for income, employment and excise taxes accruing prior to bankruptcy and owed by the bankrupt. The trustee paid $4,932.41 of taxes owing but disputed liability for $1,442.41 of tax penalties (S.R. 6–8). The taxes and penalties had been assessed against Druxman on September 6, 1957. A statement of tax due and a demand for payment had been issued ten days later. Druxman filed a voluntary petition in bankruptcy on October 18, 1957. The District Director of Internal Revenue filed a notice of tax lien on October 31, 1957 (S.R. 7). The United States asserted its claim for taxes and penalties as a secured creditor by virtue of its pre-existing lien and not as an unsecured creditor with priority (S.R. 8). The trustee paid only the principal amount of the taxes claimed (S.R. 7).

The referee held that the federal tax lien had been perfected against the trustee when the tax had been assessed and the demand for payment had been made upon the taxpayer prior to bankruptcy, even though notice of the lien was not filed until after the filing of the petition in bankruptcy (S.R. 9–11). The referee also held that Section 57j of the Bankruptcy Act applied only to unsecured claims and did not apply to disallow the payment of assessed penalties on a tax lien (S.R. 11–13).

Upon the trustee's petition for review (S.R. 28–29), the district court affirmed the order of the referee

(S.R. 27–28), and the court of appeals affirmed the order of the district court (S.R. 33–36).

Harris v. *United States*

A petition for a reorganization under Chapter X of the Bankruptcy Act, as amended, was filed as of September 30, 1955,[3] by the taxpayer and debtor, the Alaska Telephone Corporation, and was approved by the district court on November 21, 1955 (H.R. 33–34).

The United States filed proofs of claims for unpaid taxes with the trustee. Included in its claims, insofar as relevant to this proceeding, were unpaid Federal Insurance Contributions Act taxes and telephone and telegraph excise taxes for 1952 and 1953 in the amount of $56,382.93, pre-petition interest in the amount of $1,056.28, and penalties imposed on such unpaid taxes in the amount of $7,714.72, for a total amount of $65,153.93. The United States had obtained liens for these claims in 1953 and had filed notices of its liens in 1953 and 1954 before the debtor filed its petition in reorganization. (H.R. 13–20, 39–40.)[4]

A plan of reorganization was filed which, as amended, was submitted to the district court for ap-

[3] Initially this petition was filed on September 30, 1955, under Chapter XI of the Bankruptcy Act relating to proceedings in arrangements but was subsequently amended to bring the proceedings under Chapter X dealing with corporate reorganizations (H.R. 30).

[4] The United States also filed a claim for $182.86 of unpaid federal unemployment taxes for which a lien did not arise until 1956 and for which the United States did not seek to obtain interest or penalties.

proval, and which provided, among other things, for the payment of $57,000 in full settlement of the debtor's federal tax liabilities (H.R. 23–29, 38).* The trustee served notice upon the Secretary of the Treasury to accept or reject the amended plan (H.R. 32–33), and on December 26, 1958, the Acting Secretary of the Treasury, Julian A. Baird, filed a notice of rejection of the trustee's plan of reorganization with the clerk of the district court (H.R. 34–35).

Subsequently, the trustee filed objections to the claims of the United States (H.R. 13–20), which objections were heard before the referee in bankruptcy who was also designated as a special master. The referee held that the Secretary of the Treasury had failed to reject properly the proposed plan of reorganization and that therefore he must be conclusively presumed to have accepted it. The referee also held that the claims of the United States were fully satisfied by payment of the $57,000, and that the United States was not entitled to obtain assessed or other prepetition interest or penalities on its secured claims. (H.R. 34–37, 40, 41–45, 46.)

Upon a petition for review filed by the United States (H.R. 4–10, 47–53), the district court modified the order of the referee and held that the United States had properly rejected the amended plan of reorganization and that the United States was entitled to prepetition interest on the principal of all taxes owed by

* The $57,000 has been paid by the trustee to the District Director and is being held in a suspense account pending the outcome of these proceedings (H.R. 40).

the debtor. But the district court affirmed the order of the referee insofar as it disallowed the recovery of penalties on the secured claims of the United States (H.R. 55–57.) The United States appealed to the court of appeals from the disallowance of the portion of its liened claim for penalties (H.R. 58, 62–63), and the court of appeals reversed the order of the district court in this respect (H.R. 65–66).

SUMMARY OF ARGUMENT

I

Section 6321 of the Internal Revenue Code of 1954 is the statutory basis for the federal tax lien. It clearly provides that a tax penalty, as well as the tax itself, may be included as an integral part of the tax lien. Although Section 57j of the Bankruptcy Act operates to disallow all debts owing to the United States or to any of the states to the extent that the debts include penalty claims, it does not operate to disallow lien claims for penalties because that subsection, as well as all the other subsections of Section 57, is concerned with unsecured, and not secured, claims.

This conclusion accords with the structure of the Bankruptcy Act, which creates a fundamental distinction of status between secured and unsecured claims. Section 67b of the Bankruptcy Act specifically validates federal tax liens as against a trustee in bankruptcy. Under Section 67b, a lien, which is considered valid as against a bankrupt's property prior to a bankruptcy proceeding, remains valid and effec-

tive as against the trustee in bankruptcy. When property subject to a pre-existing lien passes to the trustee, it passes subject to the lien, and the trustee receives as part of the general estate only the equity in the bankrupt's estate in excess of the lien.

Although a court, under either its bankruptcy or ancillary jurisdiction, may go behind a lien and strike it down if it secures an underlying debt which is invalid under state law because it was obtained by fraud or usury, or because the statute of limitations has run, the court cannot strike down a lien which secures an underlying debt for federal tax penalties, since the debt, as well as the lien, is valid under the Internal Revenue Code. Moreover, since the lien would not be subject to Section 57j in a plenary suit brought by a trustee under the bankruptcy court's ancillary jurisdiction, it should not be considered subject to Section 57j in the bankruptcy proceedings proper, especially since in bankruptcy proceedings the lien is valid under Section 67b of the Bankruptcy Act.

The legislative history of Sections 57j and 67 also bears out the conclusion that Section 57j does not apply to a federal or state tax lien. In the early bankruptcy acts, which contained no counterpart of Section 57j, Congress specifically indicated that secured claims were to be preserved and protected, and that the rights of the United States to recover amounts due and owing were not to be impared. When Section 57j was finally enacted in 1898, Congress gave no indication that the subsection was to apply to anything other than unsecured claims. In fact, Section 67d provided that

valid liens were not to be affected by the Bankruptcy Act. Neither the 1938 Chandler Act amendments nor the 1952 amendments to the Bankruptcy Act affected the validity of federal tax liens. Moreover, although Congress amended Section 57 both in 1938 and in 1952, it failed to extend the ban of Section 57j to pre-existing tax liens. Opinions of the Sixth, Ninth, and Tenth Circuits, and of this Court in *Goggin* v. *California Labor Div.*, 336 U.S. 118, support the government's interpretation of the Bankruptcy Act.

II

Although the tax lien in *Simonson* arose and was perfected before the petition in bankruptcy was filed, notice of the lien was not filed until after the petition had been filed. The trustee argues that under Section 70c of the Bankruptcy Act he is a "judgment creditor" within the purview of Section 6323(a) of the 1954 Code, which provides that a tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor," until notice of the lien has been filed.

This court has consistently held that, in order for a creditor to qualify under Section 6323(a) as one who takes priority over the unfiled tax lien of the United States, that creditor must either be a "mortgagee, pledgee, purchaser, or judgment creditor" in the "usual, conventional sense" of the word, and that therefore, in order to qualify as a "judgment creditor," he must hold "a judgment of a court of record." *United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364. Clearly, by this standard, a trustee in bank-

ruptcy is not a "judgment creditor" for purposes of Section 6323(a), even though he is given the status of a hypothetical judicial lien creditor for limited purposes under Section 70c of the Bankruptcy Act.

Moreover, Section 67b of the Bankruptcy Act specifically recognizes the validity of a federal tax lien as against a trustee in bankruptcy. That section provides that, even if the federal tax lien arises but is not perfected before bankruptcy, the lien may nevertheless be valid if perfected within the time permitted by the statute creating the lien. Since notice of the lien cannot be filed until after the lien is perfected, a tax lien which arises *and* is perfected prior to the filing of the petition in bankruptcy should be valid under Section 70c as against the trustee, even though notice of the lien is not filed until after the petition in bankruptcy is filed. This conclusion is reinforced by Section 67c of the Act, which does not operate to invalidate federal and state statutory liens, even though it places certain limitations on them.

Thus, by virtue of the express provisions of Section 67 of the Bankruptcy Act and the judicial interpretation of Section 6323(a) of the 1954 Code, Section 70c must be interpreted as not according to the trustee the status of a hypothetical judgment creditor to enable him to oppose statutory liens for taxes, but only as according him that status to oppose contractual liens and liens obtained by legal and equitable proceedings which would have been void or voidable under state law by a creditor in the absence of bankruptcy.

ARGUMENT

I. When an addition to a Federal tax, imposed as a penalty by statute, is assessed and becomes a lien against the property of the taxpayer prior to bankruptcy, the penalty is properly allowable as a secured claim against the estate because Section 57j of the Bankruptcy Act, which disallows debt claims for penalties, applies only to unsecured claims

Section 6321 of the Internal Revenue Code of 1954 (App., *infra*, p. 42) provides that "[i]f any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any * * * assessable penalty * * *) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person." Sections 6659 and 6671 of the 1954 Code provide that a penalty may be assessed, collected and paid in the same manner as a tax and that the penalty is as integral a part of a tax lien as the unpaid principle of an assessed tax liability.

Section 67b of the Bankruptcy Act (11 U.S.C. 107, App., *infra*, pp. 45–46) provides that "statutory liens for taxes and debts owing to the United States or to any State * * *, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act * * *." But Section 57j of the Bankruptcy Act (11 U.S.C. 93, App., *infra*, p. 44) operates to disallow "[d]ebts owing to the United States or to any State * * * as a penalty or forfeiture * * *, except for the amount of the pecuniary

loss sustained by the act * * * out of which the penalty or forfeiture arose * * *."

In the present cases, valid tax liens arose in favor of the United States prior to the filing of the petitions in bankruptcy court, and these liens included both the amount of the taxes owing and the amounts of the penalties properly assessed.* There is no dispute but that, had the claims of the United States for penalties not been secured by tax liens, Section 57j would have operated to disallow such amounts. The issue here, however, is whether the government is entitled to obtain the penalty portions of its liened tax claims out of the assets in the bankruptcy or reorganization estate by reason of the status of the United States as a secured creditor. In other words, the issue is whether Section 57j applies only to invalidate unsecured claims of the United States or of a State, as the government contends, or whether it also applies to invalidate secured claims of the United States or of a State by allowing the bankruptcy court to go behind a valid tax lien in order to disallow the penalty portion of that lien, as the petitioner-trustees contend.

A. The structure of the Bankruptcy Act indicates that Section 57j does not disallow a secured claim for tax penalties

1. One of the fundamental distinctions in bankruptcy law, dating back at least to early English prac-

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*As to the rights of the United States claiming a lien on the property of a debtor, see, *e.g.*, *Glass City Bank* v. *United States*, 326 U.S. 265, 267; *United States* v. *Bess*, 357 U.S. 51; *Michigan* v. *United States*, 317 U.S. 338; *United States* v. *City of Greenville*, 118 F. 2d 963 (C.A. 4).

tice, is the distinction of status between a secured and an unsecured claim. The early English commercial statutes were concerned primarily with protecting unsecured creditors against fraudulent debtors. Under the common law of those days, the principal remedies of an unsecured creditor were those of attachment and execution. The diligent creditor who made the first seizure was entitled to priority to the full amount of his claim over creditors making later levies. As commerce developed, however, in situations in which a debtor had more than one creditor who had contributed to the common fund, each creditor was considered to be entitled to share in what was left of the debtor's property. Accordingly, the early English bankruptcy acts provided for the seizure of the bankrupt's property by a common agent acting in behalf of the unsecured creditors and for a pro rata distribution of the proceeds among the unsecured creditors. The early bankruptcy acts made no provision for the secured creditors, however. Property subject to a security was not considered to be part of the bankrupt's estate or to come within bankruptcy proceedings, and a secured creditor was left to his common law remedies to enforce his lien. See 1 Remington, *Bankruptcy,* pp. 4–21 (4th ed.).

This distinction between the status of a secured and an unsecured claim is mirrored in the structure of the Bankruptcy Act. Whereas Sections 57, 63, and 64 of the Act (11 U.S.C. 93, 103, 104) apply generally to the proof and allowance of claims and the priority of payment among unsecured creditors, Sections 60, 67

and 70 (11 U.S.C. 96, 107, 110) relate generally to preferences and liens of secured creditors.

Although Section 64 (App., *infra*, pp. 44–45) establishes priorities among certain classes of unsecured creditors for payment out of the general assets of the bankrupt's estate, no similar provision establishes any priorities for secured creditors; rather, the order of payment to secured creditors is based upon the common law principles governing the priority of their respective liens—generally the principle of first in time, first in right.[7] Moreover, a contingent claim is not provable against the general estate under Section 63, but an existing lien for a contingent claim is valid.[8] Similarly, although unsecured rentals do not constitute a provable claim against the general estate, a lien for rentals is not affected by bankruptcy of the lessee; rather, once the trustee has converted the bankrupt's property into cash, the lien creditors are entitled to rental payments from the proceeds.[9] Furthermore, a secured creditor is not entitled to vote or

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[7] See, *e.g.*, *In re Pennsylvania Central Brewing Co.*, 114 F. 2d 1010 (C.A. 3); *DeLaney* v. *City and County of Denver*, 185 F. 2d 246, 249–250 (C.A. 10); 3 Collier, *Bankruptcy*, Sec. 64.02 (14th ed., 1956). Thus, payment of a landlord's lien is not governed by Section 64, and even though a claim for local taxes has first priority under Section 64, the landlord's lien takes precedence over the tax claim. *City of Richmond* v. *Bird*, 249 U.S. 174; see *Ingram* v. *Coos County*, 71 F. 2d 889 (C.A. 9); *In re Brannon*, 62 F. 2d 959 (C.A. 5), certiorari denied *sub nom. Ryan* v. *City of Dallas*, 289 U.S. 742.

[8] See *Security Mortgage Co.* v. *Powers*, 278 U.S. 149, 155–156.

[9] See *Martin* v. *Orgain*, 174 Fed. 772, 778–779 (C.A. 5), certiorari denied, 216 U.S. 619; *Britton v. Western Iowa Co.*, 9 F. 2d 488 (C.A. 8).

participate at creditor's meetings and is not entitled to have his claims counted with those of unsecured creditors except insofar as his claim is in excess of his security interest.[10] Nor are lienholders required to contribute to the general expenses of administration, but only to those expenses concerned with the property subject to the liens.[11]

Basic to the distinction between secured and unsecured claims in bankruptcy proceedings is the fact that an unsecured creditor, including one with a priority under Section 64, must enter a bankruptcy proceeding, and file and prove his claim under Section 57 to receive even a pro rata share of the claim. On the other hand, a secured creditor, if properly and solely in possession of the property upon which he has a lien, "may disregard the bankruptcy proceeding, decline to file a claim and rely solely upon his security * * *." *United States Nat'l Bank* v. *Chase Nat'l Bank,* 331 U.S. 28, 33. In such circumstances, the bankruptcy court has only ancillary jurisdiction to determine the validity or the amount of the lien (see Section 2a(20) of the Bankruptcy Act, 11 U.S.C. 11, App., *infra,* pp. 43–44); the trustee must bring a plenary suit for those purposes. If the lienholder were either the United States or one of the States, it would thereupon be entitled to any penalties accruing on the obligation out of the property secured by the lien, for

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[10] See Sections 56b, 57e, 59e(4) of the Bankruptcy Act (11 U.S.C. 92, 93, 95).

[11] See *Reconstruction Finance Corp.* v. *Cohen,* 179 F. 2d 773, 776–777 (C.A. 10); 6 Remington, *Bankruptcy,* Secs. 2609–2610 (5th ed., 1952).

neither Section 57j nor any other section of the Bankruptcy Act pertaining to bankruptcy proceedings proper would have any application in an ancillary suit.

If, on the other hand, the property upon which the lien attached "is within the jurisdiction of the bankruptcy court," the secured creditor "must file a secured claim * * * if he wishes to retain his secured status," because the bankruptcy court "has exclusive jurisdiction over the liquidation of the security." *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 33–34.[12] Even in this situation, however, the secured creditor is not required to file proof of the secured claim under Section 57,[13] as does an unsecured creditor, but instead may file an intervening petition with the bankruptcy court.[14] Moreover, even if the secured creditor elects to file proof of the secured claim, the filing does not deprive him of his secured status,[15] because Section 67b of the Bankruptcy Act expressly preserves the validity of an existing lien, and a lien which is con-

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[12] A secured creditor may also "waive his security and prove his entire claim as an unsecured one * * * [or] avail himself of his security and share in the general assets as to the unsecured balance." *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 34; see Sections 57e, g, and h of the Act (11 U.S.C. 93).

[13] *Allen* v. *See,* 196 F. 2d 608, 610 (C.A. 10); *Brans* v. *City of Dallas,* 217 F. 2d 640 (C.A. 5).

[14] See, *e.g., California State Board of Equalization* v. *Coast Radio Products,* 228 F. 2d 520, 525–526 (C.A. 9); *United States* v. *England,* 226 F. 2d 205 (C.A. 9); *DeLaney* v. *City and County of Denver, supra,* 185 F. 2d at 251–252; *Gotkin* v. *Korn,* 182 F. 2d 380, 382 (C.A.D.C.).

[15] See *Reconstruction Finance Corp.* v. *Cohen, supra,* 179 F. 2d at 776–777.

sidered valid as against the bankrupt's property prior to the bankruptcy proceeding remains valid and effective as against the trustee. Thus when property subject to a pre-existing valid lien passes to the trustee under Section 70a of the Bankruptcy Act (11 U.S.C. 110, App., *infra*, p. 47), it passes subject to the lien.[16] The trustee receives as part of the general estate only the equity in the bankrupt's estate in excess of the lien [17] and therefore takes possesion only of such property and rights to property as the bankrupt possessed as of the date of the commencement of the bankruptcy proceeding.[18]

Section 57j has no application in determining the extent of a federal or state lien and the amount of the equity in excess thereof, for that section applies only

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[16] See *Burton* v. *Smith*, 13 Pet. 464, 483; *Michigan* v. *United States*, 317 U.S. 338, 340; *United States* v. *Bess*, 357 U.S. 51, 57.

[17] See *Security Mortgage Co.* v. *Powers*, *supra*, 278 U.S. at 153; *In re Quaker City Uniform Co.*, 134 F. Supp. 596 (E.D. Pa.), reversed on other grounds, 238 F. 2d 155 (C.A. 3), certiorari denied, 352 U.S. 1030.

[18] Sections 60 and 67 of the Bankruptcy Act allow the trustee to avoid certain existing liens and therefore vest him with certain rights which are greater than those of the bankrupt. Section 60 invalidates preferences relating to contractual and judicial liens, but not preferences relating to statutory liens. Section 67a invalidates judicial liens obtained within four months before bankruptcy if the bankrupt had been insolvent. Section 67d invalidates certain fraudulent liens obtained within one year prior to bankruptcy. Section 67c(2) invalidates state statutory liens for debts on personal property not reduced to possession. None of these provisions invalidate pre-existing tax liens of the United States. See *Goggin* v. *California Labor Div.*, 336 U.S. 118, 126–127; *California State Department of Employment* v. *United States*, 210 F. 2d 242 (C.A. 9); *Rochelle* v. *City of Dallas*, 264 F. 2d 166 (C.A. 5).

to federal and state claims against the estate, *i.e.*, against the equity and other lien-free property of the bankrupt. It follows that the extent of the lien is governed by Section 67b without regard to the type of debt secured.

Any other conclusion would create discordance between the evident status of a secured creditor in possession of the property and one holding a lien upon property within the jurisdiction of the bankruptcy court. Not only is it unlikely that Congress intended this unwarranted distinction, but to draw it would encourage an unseemly race between the lien holder and the trustee to gain possession of the property of the bankrupt.

Thus, the historical difference between the right of secured creditors to retain their property interest and the rules governing distribution of the bankrupt's estate, which is preserved in the structure of the Bankruptcy Act, indicates that Section 57j should have no greater application to secured claims than any of the other subsections of Section 57, which plainly have none.[19]

2. Petitioner-trustees attempt to dispute (Pet. Br. 10, 13–14) the foregoing interpretation of Section 57j of the Act by relying on the doctrine enunciated in *Pepper* v. *Litton*, 308 U.S. 295, 305–306, that "a bankruptcy court has full power to inquire into the validity of any claim asserted against the estate and to disallow it if it is ascertained to be without lawful

[19] Although Sections 57e, g, and h apply to claims of secured creditors, they only govern the unsecured portions of those claims.

existence. * * * And the mere fact that a claim has been reduced to judgment does not prevent such an inquiry." Both the Fifth Circuit in *United States* v. *Phillips*, 267 F. 2d 374, and the Fourth Circuit in *United States* v. *Harrington*, 269 F. 2d 719, followed this doctrine in invalidating the government's secured claims for tax penalties.

The government does not dispute that a court, under either its bankruptcy or ancillary jurisdiction, has full power to go behind a lien to determine the validity of the underlying debt. What the government does dispute is the standard which the court must apply in determining the validity of secured claims. A typical standard is whether the underlying debt is invalid under state law, either because the statute of limitations has run, or because of fraud or usury. This standard is embodied in Section 70c of the Bankruptcy Act (11 U.S.C. 110, App., *infra*, pp. 47–48) which accords to the trustee "the benefit of all defenses available to the bankrupt as against third persons, including statute of limitations, statute of frauds, usury, and other personal defenses." In the *Pepper* case, the court struck down the lien because both the underlying debt and the judgment lien which secured it were obtained as part of a "planned and fraudulent scheme" to defraud the sole remaining creditor of a corporation (308 U.S. at 312). But the fact that a debt for tax penalties due and owing the United States is disallowable as an unsecured claim in bankruptcy under Section 57j of the Bankruptcy Act does not make Section 57j a standard by which

a bankruptcy court may determine the validity of a secured claim for tax penalties. In a plenary suit brought by the trustee under a bankruptcy court's ancillary jurisdiction, the court would certainly never invalidate the lien for tax penalties, because the penalties as well as the lien are completely valid under Sections 6321, 6659, and 6671 of the Internal Revenue Code of 1954 (see Section 2a(20) of the Bankruptcy Act; *supra*, pp. 15–16). Similarly, the court, under its bankruptcy jurisdiction should not be able to invalidate the lien for tax penalties on the basis of Section 57j (see *supra*, pp. 16–18), especially since the lien is given express validity in bankruptcy proceedings under Section 67b of the Bankruptcy Act.

B. The legislative history of Sections 57j and 67, and the judicial interpretation of that history, support the allowance of liened claims for penalties

1. *The early bankruptcy acts.*—There was no counterpart to Section 57j in the three early bankruptcy acts. See Act of April 4, 1800, c. XIX, 2 Stat. 19;[20] Act of August 19, 1841, c. IX, 5 Stat. 440;[21] Act of March 2, 1867, c. CLXXVI, 14 Stat. 517.[22] In the early acts, Congress specifically indicated that secured claims should be preserved and protected, and that the rights of the United States to recover amounts due and owing should not be impaired. See Act of April 4, 1800, *supra*, Secs. 62, 63; Act of August 19,

[20] Repealed by Act of December 19, 1803, c. VI, 2 Stat. 248.

[21] Repealed by Act of March 3, 1843, c. LXXXII, 5 Stat. 614.

[22] Amended by Act of June 22, 1874, c. 390, 18 Stat. 178; repealed by Act of June 7, 1878, c. 160, 20 Stat. 99.

1841, *supra*, Sec. 2; Act of March 2, 1867, *supra*, Secs. 14, 20, 28.

Between 1878 and 1898, numerous bankruptcy bills were introduced in Congress. In 1892, a provision disallowing the payment of penalties was introduced, but failed to pass. H.R. 9348, 52d Cong., 1st Sess., Sec. 57j. Although the majority of the House Committee on the Judiciary made no reference to the proposed Section 57j (see H. Rep. No. 1674, 52d Cong., 1st Sess.), the minority expressed concern that the proposed section might disallow the payment of penalties which merged into a judgment (see *id.* (Part 2), pp. 13–14).

2. *The Bankruptcy Act of 1898.*—Section 57j was finally enacted as a part of the Bankruptcy Act of 1898, c. 541, 30 Stat. 544. The Committee reports contained no reference to Section 57j. See H. Rep. No. 65, 55th Cong., 2d Sess., to accompany S. 1035, 55th Cong., 1st Sess.; S. Doc. No. 294, 55th Cong., 2d Sess. Nor did Congress give any other indication that Section 57j was applicable to anything but unsecured claims. All the other subsections of Section 57 related only to the unsecured portion of claims. Moreover, Section 67d provided that "[l]iens given or accepted in good faith and not in contemplation of or in fraud upon this Act * * * shall not be affected by this Act." Under Section 67d, penalties which had become a part of a lien would not be "affected" by any other provision of the Bankruptcy Act, including the prohibition in Section 57j. This interpretation of the status of a lien under Section 67d was expressly adopted by the Ninth Circuit in *In re Knox-*

Powell-Stockton Co., 100 F. 2d 979, 983–984, in which the court stated that, although "section 57j * * * precludes the 'allowance' of a claim for penalties," the section does not come into operation "where a lien exists to support a penalty at the time of adjudication" because "adjudication in bankruptcy does not affect a valid and existing lien * * *." Accord, *Commonwealth of Kentucky* v. *Farmers Bank & Trust Co.*, 139 F. 2d 266 (C.A. 6).

3. *The Chandler Act.*—In 1938, Congress passed the Chandler Act, c. 575, 52 Stat. 840, as a revision of the Bankruptcy Act. None of the Chandler Act amendments gave any indication that Section 57j was to apply to secured claims. The amendment to Section 57n, which required the United States to prove and file its claim for taxes, applied only to unsecured claims of the United States and not to those secured by pre-existing liens. The Chandler Act's reduction in priority of tax-claim payments from first to fourth under Section 64 affected only claims which were unsecured.

The Chandler Act amendments to Section 67, in particular, the deletion of Section 67d of the Act of 1898, evidenced no intention to assimilate the status of secured tax claims to the status of unsecured tax claims. The new Section 67b preserved the validity of statutory liens, including liens for taxes and debts owing to the United States or to any State or its subdivisions. Although Section 67c (11 U.S.C. 107, App. *infra*, pp. 46–47) "postponed" the payment of valid statutory liens on personal property not accompanied by possession until the

debts for certain administrative expenses and wages specified in Section 64a (1) and (2) of the Act were paid, there was no indication that the tax lien itself, or any part of it, was to be disregarded and the taxes paid as a priority claim.

Despite the limited effect of the Chandler Act, the trustees (Pet. Br. 14) rely upon dictum in *Gardner* v. *New Jersey*, 329 U.S. 565, 580–581, to support their view of Section 57j, for the Court there stated:

> The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission* v. *Thompson, supra.* There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. Section 57j of the Bankruptcy Act provides that debts owing a State as a "penalty or forfeiture" shall not be allowed. What claims accruing before bankruptcy and sought to be proved by a State are "penalties," *New York* v. *Jersawit*, 263 U.S. 493, and what are not, *Meilink* v. *Unemployment Reserves Commission*, 314 U.S. 564, * * * are * * * questions for the reorganization court.

There is considerable question whether this language has any great significance with respect to an ordinary bankruptcy proceeding. The *Gardner* case was a railroad reorganization proceding under Section 77

of the Bankruptcy Act (11 U.S.C. 205), which vests a court and the trustee with extremely broad powers over all types of liens. The court in a regular bankruptcy proceeding has no such broad powers. See 329 U.S. at 576."

Moreover, subsequent to the *Gardner* decision, this Court decided in *Goggin* v. *California Labor Div.*, 336 U.S. 118, that the Chandler Act did nothing to invalidate statutory liens, and cited with approval the Ninth Circuit's decision in the *Knox-Powell-Stockton* case, *supra*, which had held that a pre-existing tax lien is indefeasible in bankruptcy even if it secures an under-

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" It should also be noted that no penalties were involved in *Gardner*, and that the case reached the Court solely on the issue whether the reorganization court had jurisdiction to adjudicate the state's claim for taxes and interest secured by a lien. In fact, the Court refrained from intimating any "opinion on the merits of the settlement controversy," or "any view on the amount of the tax claim which should be allowed or on the validity, character, priority, or extent of the lien asserted by New Jersey, or on the manner in which it should be satisfied in a plan for reorganization" (329 U.S. at 584). The Court went on to hold only "that the reorganization court could properly entertain all objections to the claim except those involving the valuations underlying the assessments and the validity of those assessments" (*ibid.*). Moreover, the two cases cited by the Court, *New York* v. *Jerswoit*, 263 U.S. 493, and *Meilink* v. *Unemployment Reserves Commission*, 314 U.S. 564, involved only unsecured claims. Thus Section 57j was of course applicable to that part of the unsecured claims which represented penalties. The question presented in those cases was whether the contested amounts represented interest rather than penalties.

lying debt for tax penalties. As the Court in *Goggin* stated (336 U.S. at 126–127):

> While § 67c was added to the Bankruptcy Act by the Chandler Act in 1938, we find nothing in it or in its legislative history to suggest an abandonment of * * * the general purpose of Congress to continue to safeguard interests under liens perfected before bankruptcy. * * * *In re Knox-Powell-Stockton Co.*, 100 F. 2d 979 * * *. While § 64, as amended, somewhat readjusts priorities among unsecured claims, § 67 continues to recognize the validity of liens perfected before bankruptcy as against unsecured claims. Section 67b has clarified the validity of statutory liens, including those for taxes, even though arising or perfected while the debtor is insolvent and within four months of the filing of the petition in bankruptcy. * * *

The claim of the United States in the *Goggin* case involved penalties as well as taxes, all secured by perfected liens, and the penalties were allowed as a secured claim without objection that they were not allowable under Section 57j.

4. *The 1952 amendments to the Bankruptcy Act.*— The decisions by the Sixth and Ninth Circuit Courts of Appeals and by this Court preceded the 1952 amendments to the Bankruptcy Act. In the Act of July 7, 1952, c. 579, 66 Stat. 420, Congress specifically amended Sections 57j, 67b and 67c but, despite the judicial decisions, it did not extend the ban of Sec-

tion 57j to perfected tax liens.[24] It is a fair inference that Congress was satisfied with the judicial interpretation; certainly Congress had no affirmative intention to make a change.[25] As the Tenth Circuit stated in *Grimland* v. *United States*, 206 F. 2d 599, 601, a case which adhered to the *Knox-Powell-Stockton* interpretation: "It may well be that Congress had

[24] The amendment to Section 57j merely substituted the words "on the amount of such loss" for the word "thereon" to express more clearly how much interest was allowable. The amendment to Section 67b merely employed a revised definition of the petition filed in bankruptcy. The amendment to Section 67c introduced subsection (2) which deprived certain state and local statutory liens for debts on personal property not reduced to possession of their secured status. But this provision did not affect the validity of liens for taxes, whether imposed by the federal, state or local government.

[25] There have been several recent attempts to provide by legislation that, where a penalty not allowable under Section 57j is secured by a lien, the portion of the lien securing such penalty shall be disallowed. In H.R. 5195, 85th Cong., 1st Sess., and in H.R. 4158, 86th Cong., 1st Sess., the proposed amendments were made to Section 67c, whereas in H.R. 6787, 85th Cong., 1st Sess., Section 57j specifically was made applicable to debts whether or not secured by a lien. None of these proposed amendments were reported out of the House Committee on the Judiciary. In H.R. 7242, 86th Cong., 1st Sess., Sec. 6, it was proposed to amend Section 57j to apply to penalties, "whether or not secured by a lien." This bill passed the Congress in August 1960 (106 Cong. Rec. 17591), but was vetoed by the President on September 8, 1960 (106 Cong. Rec. 19168). Similar provisions are included in H.R. 1961, 87th Cong., 1st Sess., Sec. 2, which passed the House of Representatives on August 7, 1961 (107 Daily Cong. Rec. 13703), and is currently pending (October 1961) before the Senate Committee on the Judiciary. S. 1142, 87th Cong., 1st Sess., Sec. 2, the counterpart to H.R. 1961, has not been reported out by the Senate Committee on the Judiciary.

in mind that claims for tax penalties should not be allowed in bankruptcy, even though a lien has been perfected before adjudication, but the language of 57, sub. j does not adequately express that intent. We therefore hold that the claim may be enforced to the extent of the lien." Accord, *United States* v. *Mighell*, 273 F. 2d 682 (C.A. 10.)

C. Equitable considerations are not persuasive in supporting the Trustees' contention that Section 57j applies to a secured claim for tax penalties

The trustees argue (Pet. Br. 15–17) that, if the government were to be allowed to receive payment on its lien for a debt of tax penalties, the innocent unsecured creditor would be the one penalized rather than the delinquent taxpayer. But what the equities are to be between secured and unsecured creditors is a matter of policy for Congress to decide, and not the courts. As the structure and the legislative history of the Bankruptcy Act has indicated, Congress deliberately intended to grant priorities to secured creditors with valid liens at the expense of the unsecured creditors.

Congress has long favored the United States with respect to the collection of the public revenues which, by statute, may include penalties. The obligation of a bankrupt's estate to pay taxes may very well leave an unsecured creditor with empty hands. Although Congress has long been aware of the plight of the unsecured creditor and the hardships worked on him by the priority rights of secured creditors, including the United States, it nevertheless has always sought to protect the public revenue as well as to protect

secured creditors, and, in doing so, it has never seen fit to invalidate a secured tax obligation of the United States. See *Glass City Bank* v. *United States,* 326 U.S. 265, 267.

Moreover, the priority rights of a secured creditor, as well as the priority rights of the United States, claiming either as a secured or unsecured creditor, are not unique to bankruptcy. Ever since 1797, the United States has had an absolute priority for debts due from an insolvent debtor. Rev. Stat. 3466, 31 U.S.C. 191. Moreover, secured creditors consistently have received greater rights in equity receivership proceedings than in bankruptcy to the detriment of the general unsecured creditors. Thus, in a bankruptcy proceeding, a secured creditor must first exhaust his security before proving his claim for the balance on a pro-rata basis with the unsecured creditor, whereas in an equity-receivership proceeding, a secured creditor may first satisfy his claims out of the common fund while still reserving his security against any deficiency. See *Merrill* v. *National Bank of Jacksonville,* 173 U.S. 131; *United States Nat'l Bank* v. *Chase Nat'l Bank, supra,* 331 U.S. at 34.

In the present situation, Congress under Section 6321 of the 1954 Code has allowed penalties to be included in a tax lien and has provided in Section 67b of the Bankruptcy Act that the tax lien shall be valid in the bankruptcy proceedings. To now advance the contention that the penalty portion of a valid lien is to be disallowed on the ground that it is not fair to unsecured creditors, and that Congress never intended to deplete the assets available for such

unsecured creditors, is to fly in the face of the basic intention of Congress, as evidenced by the history of legislation in the tax, insolvency and bankruptcy areas, to assure the collection of the revenues of the United States.

Whenever Congress has deemed as unjust the granting of a priority to the tax obligation or any part thereof over other creditors, it has amended the law to reflect that intention, and then only to the extent of protecting certain specified groups of creditors under certain limited conditions.[26] But where Congress consistently and expressly has provided that the tax lien should be valid and has not expressly restricted the payment of any portion of the lien, there should be no basis for contending that part of the lien should be invalidated because of alleged hardships worked on lower ranking creditors.

The trustees' contention (Pet. Br. 15–17) that it would be more equitable to require the taxpayer to pay the penalties out of after-acquired assets than to

[26] Thus, the Chandler Act amended Section 57n to require the United States to file and prove its unsecured claims for debts and taxes; the Chandler Act in Section 64a reduced the priority of payment of unsecured tax claims of the United States to the fourth priority, behind claims for costs of administration, certain wage claims and specified expenses of certain creditors; the Chandler Act amended Section 67c to postpone the payment of statutory liens for taxes owing to the United States and for statutory liens for taxes owing to a state or subdivision on personal property not reduced to possession to the payment of claims for costs of administration and certain wage claims; the Act of July 7, 1952, Sec. 21(d), c. 579, 66 Stat. 420, invalidated statutory liens for debts owing to states or their subdivisions on personal property not reduced to possession.

permit collection of the penalties out of the bankruptcy estate, is immaterial,[27] for the contention would be equally applicable with respect to the principal amount of the taxes owing, as well as to other provable claims which are not affected by discharge. Nevertheless, neither the United States nor other creditors with non-dischargeable provable debts have been barred from recovering those debts out of the assets in the bankruptcy estate. Moreover, if the trustees' contention were to prevail, it would mean that the collection of the penalties would depend upon such considerations as whether the taxpayer would continue to exist after bankruptcy or reorganization, or whether it would acquire assets after bankruptcy, or whether a subsequent recovery against a reorganized debtor or a successor would or would not be barred by statute. See Section 77f (11 U.S.C. 205), relating to railroad reorganizations, and Sections 224, 226, 227, and 228 (11 U.S.C. 624, 626, 627, 628), relating to corporate reorganizations. In fact, in the *Harris* case it is very doubtful whether the United States can obtain the penalties involved except out of the estate in reorganization.

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[27] As the trustees note (Pet. Br. 16), the only decision of a court of appeals on point is *United States* v. *Mighell*, 273 F. 2d 682 (C.A. 10), which held that the United States was entitled to obtain penalties on its liened claims for taxes only to the extent of the assets in the bankruptcy estate but not out of after-acquired assets of the taxpayer. The court therefore enjoined the District Director from attempting to collect the balance of the penalties owing from after-acquired assets of the taxpayer. Cf. *Bruning* v. *United States*, 7 A.F.T.R. 2d 1431 (S.D. Calif., April 19, 1961), currently on appeal by the taxpayer in the Ninth Circuit.

II. A Federal tax lien which arises prior to the filing of a petition in bankruptcy is valid as against the trustee in bankruptcy even though notice of the lien is filed subsequent to the filing of the petition in bankruptcy because, with respect to the tax lien, the trustee is not a "judgment creditor" within the meaning of either Section 70c of the Bankruptcy Act or Section 6323(a) of the Internal Revenue Code of 1954

As an alternative argument, petitioner-trustee in *Simonson* contends that, even if Section 57j does not operate to invalidate the federal lien securing the debt for tax penalties, that lien is invalid under Section 70c of the Bankruptcy Act (11 U.S.C. 110, App., *infra,* pp. 47–48) and Section 6323(a) of the Internal Revenue Code of 1954 (App., *infra,* pp. 42–43[28] Section 70c provides that the trustee shall be deemed vested, as of the date of bankruptcy, with all the rights, remedies and powers of a judgment lien creditor, whether or not such a creditor actually exists.[29] Section 6323(a) provides that a federal tax lien "shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor unless notice thereof has

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[28] Petitioner in *Simonson* does not contest the lien for the principal amount of the taxes, because he has already paid the debt on that part of the lien (S.R. 7; see the Statement, *supra,* p. 4).

[29] The pertinent language of Section 70c is as follows:
"The trustees, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien theron by such proceedings, whether or not such a creditor actually exists."

been filed * * *." In *Simonson*, although the tax lien arose before the petition in bankruptcy was filed, notice of the lien was not filed until after the petition had been filed. Petitioner-trustee in *Simonson* argues that the two sections accord him the status of a "judgment creditor" for purposes of invalidating the federal tax lien as to which notice had not been filed prior to bankruptcy. The court of appeals correctly rejected this contention.

A. Although Section 70c of the Bankruptcy Act accords to the trustee the status of a hypothetical judgment creditor, the trustee is not a "judgment creditor" within the meaning of Section 6323(a) of the Internal Revenue Code of 1954 for purposes of invalidating the Federal tax lien

1. *Judicial interpretation of Section 6323(a).*— This Court has consistently held that, in order for a creditor to qualify under Section 6323(a) of the 1954 Code, or its predecessor provision, Section 3672(a) of the 1939 Code, as one who takes priority over the unfiled tax lien of the United States, that creditor must be either a "mortgagee, pledgee, purchaser, or judgment creditor" in the "usual, conventional sense" of the word. *E.g., United States* v. *Gilbert Associates, Inc.*, 345 U.S. 361, 364. By this standard, a "judgment creditor" for purposes of Section 3672(a) is one holding a "judgment of a court of record, since all states have such courts" (*ibid.*; see *United States* v. *Security Trust & Savings Bank*, 340 U.S. 47, 52 (Jackson, J., concurring)), and a "purchaser" is "one who acquires title for a valuable consideration in the manner of vendor or vendee" (*United States* v.

Scovil, 348 U.S. 218, 221).[20] Accord, *United States* v. *Ball Construction Co.*, 355 U.S. 587 (mortgagee); *United States* v. *White Bear Brewing Co.*, 350 U.S. 1010 (purchaser). Clearly, by this standard, a trustee in bankruptcy could not be considered a "judgment creditor" for purposes of Section 6323(a) of the 1954 Code.[21] In fact, every court of appeals which has considered the question has held that the provision in Section 70c of the Bankruptcy Act giving the trustee the status of a hypothetical judicial lien creditor does not make him a "judgment creditor" within the meaning of Section 6323(a) of the 1954 Code or its 1939 Code predecessor. *United States* v. *England*, 226 F. 2d 205 (C.A. 9); *In re Fidelity Tube Corp.*, 278

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[20] See also as to the word "purchaser", *United States* v. *Chapman*, 281 F. 2d 862, 868–869 (C.A. 10); *United States* v. *Hawkins*, 228 F. 2d 517 (C.A. 9); *New York Terminal Warehouse Co.* v. *Bullington*, 213 F. 2d 340, 344 (C.A. 5); *National Refining Co.* v. *United States*, 160 F. 2d 951, 955 (C.A. 8).

[21] Although, as the trustee in *Simonson* points out (Pet. Br. 19–20), the decisions in this Court in *Gilbert Associates* and similar cases did not directly adjudicate the rights of a trustee in bankruptcy, nevertheless the logic of those decisions is equally compelling in the present case. Similarly, although in *Gilbert Associates* concern was expressed that a particular class of creditors be treated uniformly, there is no merit to the trustee's contention (Pet. Br. 20) that there is no problem of nonuniformity in the present case. Recently, the Third Circuit in *In re Fidelity Tube Corp.*, *supra*, 278 F. 2d 776, 781, certiorari denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828, pointed out that, if the four protected classes of creditors listed in Section 6323(a) are to be defined one way when a debtor is solvent or when there is an insolvency or equitable receivership proceeding, but defined another way with respect to a trustee in a bankruptcy proceeding, a problem of nonuniformity will arise.

F. 2d 776 (C.A. 3), certiorari denied *sub nom. Borough of East Newark* v. *United States*, 364 U.S. 828; *Brust* v. *Sturr*, 237 F. 2d 135 (C.A. 2); *In re Taylorcraft Aviation Corp.*, 168 F. 2d 808, 810 (C.A. 6). See also *In the Matter of Green*, 124 F. Supp. 481 (N.D. Ala.); *In re Ann Arbor Brewing Co.*, 110 F. Supp. 111, 115–116 (E.D. Mich.).

2. *The legislative history of Section 6323(a).*— The meaning given by this Court to the term "judgment creditor" in Section 6323(a) is substantiated by the legislative history of the federal tax-lien statutes. Initially there was no provision in the tax-lien statute which protected a mortgagee, pledgee, purchaser, or judgment creditor from an unfiled tax lien. Rev. Stat. 3186, as amended, Act of March 1, 1879, Sec. 3, c. 125, 20 Stat. 327.[29] In 1893, this Court held in *United States* v. *Snyder*, 149 U.S. 210, that the tax lien was valid even against a bona-fide purchaser for value without knowledge or notice of the existence of the lien. To alleviate this situation, Congress further amended the tax-lien statute in 1913 to provide that the lien should not be valid as against any mortgagee, purchaser, or judgment creditor until notice of the lien had been filed. Act of March 4, 1913, c. 166, 37

[29] Prior to 1913, the language of Rev. Stat. 3186 was as follows:

"If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount shall be a lien in favor of the United States from the time when the assessment-list was received by the collector, except when otherwise provided, until paid, with the interest, penalties, and costs that may accrue in addition thereto, upon all property and rights to property belonging to such person."

Stat. 1016;[9] see H. Rep. No. 1018, 62d Cong., 2d Sess., p. 2; S. Rep. No. 1315, 63d Cong., 3d Sess, p. 2. Subsequently, in 1939, Congress again amended the lien provision (then Section 3672 of the Internal Revenue Code of 1939) to extend similar protection to a "pledgee." Revenue Act of 1939, Sec. 401, c. 247, 53 Stat. 862. Thus, Congress was apparently interested in protecting as against an unfiled tax lien only certain enumerated classes of secured creditors within the conventional meaning of the terms used.

This conclusion is reinforced by the legislative history of Section 6323 of the 1954 Code. The House version of proposed Section 6323 contained a subsection (c) which provided that only a judgment creditor who actually had obtained a valid judgment in a court of record and had a perfected lien under such judgment was to be protected under Section 6323. The House Committee pointed out that subsection (c) was designed to continue by statute the rule developed by existing court decisions. See H. Rep. No. 1337, 83d Cong., 2d Sess., p. A407 (3 U.S.C. Cong. & Adm. News (1954) 4017, 4554–4555).

Although the Senate version of the section deleted subsection (c) of the House bill, the Senate Committee pointed out that the rule which the House bill would prescribe by statute through subsection (c) was

[9] The pertinent language added by the 1913 amendment was as follows:

"*Provided, however*, That such lien shall not be valid as against any mortgagee, purchaser, or judgment creditor until notice of such lien shall be filed by the collector in the office of the clerk of the district court of the district within which the property subject to such lien is situated * * *."

unnecessary because it already existed by judicial construction, and that judicial interpretation of the existing law was preferable to a prescribed statutory rule. See S. Rep. No. 1622 to accompany H.R. 8300, 83d Cong., 2d Sess., p. 575 (3 U.S.C. Cong. & Adm. News (1954) 4621, 5224). As the Senate Committee stated (*ibid.* (emphasis added)): "*As under existing law*, a person who is *in fact* a mortgagee, pledgee, purchaser, or judgment creditor will be entitled as such to the protection of this section * * *."

In conference, the House agreed to the deletion of subsection (c) of Section 6323 of the House bill. Thus, both Houses of Congress were unanimous in accepting the rule of law established in the *Gilbert Associates* case, *supra*, and similar decisions. As the Conference Committee stated in its Report (H. Conf. Rep. No. 2543, 83d Cong., 2d Sess., p. 78 (3 U.S.C. Cong. & Adm. News (1954) 5280, 5340)):

> * * * Subsection (c) of section 6323 of the House bill provided certain specific rules with respect to the validity of the tax lien, without the filing of notice thereof, as against mortgagees, pledgees, purchasers, and judgment creditors. The Senate amendment strikes out this subsection, thereby continuing in effect the existing law, including applicable rules which have been developed by judicial construction. The House recedes.

Had Congress intended to broaden the existing rule to include a trustee in bankruptcy as a "judgment creditor" within the protection of Section 6323(a), it easily could have done so by clear and appropriate language.[44]

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[44] Legislation has recently been proposed to constitute a trustee in bankruptcy as a "judgment creditor" with respect to

3. *Equitable Considerations.*—Even if the trustee were to be considered a "judgment creditor" for purposes of Section 6323(a), the prior secured creditors would not obtain any advantage which they presently do not have under Section 6323(a). Furthermore, with respect to the claim for federal taxes itself, the requirement that notice of the tax lien be filed will not benefit the general creditors, for whom the trustee acts, because, even if the tax lien were invalidated, the principal of the federal tax would still be payable, under Section 64a(4) of the Bankruptcy Act, as a priority claim before the claims of the general creditors. Apparently, as the trustee in *Simonson* recognizes (Pet. Br. 23–25), the persons who normally benefit by an invalidation of a federal tax lien are not the general unsecured creditors, but (1) those whose claims fall within Section 64a (1)

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federal tax liens. See H.R. 7242, 86th Cong., 1st Sess., Sec. 6, which passed Congress in August 1960 (106 Cong. Rec. 17591), but was vetoed by the President on September 8, 1960 (106 Cong. Rec. 19168); H. Rep. No. 745, 86th Cong., 1st Sess., pp. 9–10; S. Rep. No. 1871, 86th Cong., 2d Sess., pp. 10–11. See also H.R. 1961, 87th Cong., 1st Sess., Sec. 7, which passed the House of Representatives on August 7, 1961 (107 Daily Cong. Rec. 13703), and is currently pending before the Senate Committee on the Judiciary; H. Rep. No. 708, 87th Cong., 1st Sess., pp. 10–12; S. 1142, 87th Cong., 1st Sess., Sec. 7, which has not been reported out by the Senate Committee on the Judiciary. The committee reports all underscore the need for Congressional action if the trustee is to be given the rights of a "judgment creditor" with respect to the federal tax lien.

Compare Section 101 of H.R. 7914, H.R. 7915, H.R. 8406 and S. 2305, 86th Cong., 1st Sess., which would have confirmed the Supreme Court's definition in *Gilbert Associates*. "To qualify for priority under this provision, a judgment must have been rendered by a court in a judicial proceeding." American Bar Association Committee on Federal Liens, *Final Report*, p. 91 (Feb. 23, 1959).

through (3) of the Bankruptcy Act, *i.e.*, claims for administration costs and expenses, limited wage claims and claims for certain extraordinary expenses of creditors; and (2) states and municipalities, which would be entitled to share as priority claimants on an equal basis with the United States, to the extent that their liens, which are junior to the federal tax lien, would be invalid in bankruptcy proceedings. It is difficult to see why these claimants should require notice of the filing of the tax lien of the United States. Certainly, Congress has not considered that these classes of creditors require protection, since Congress has not added any of these classes to the four enumerated in Section 6323(a)."

B. Although Section 70c of the Bankruptcy Act accords to the trustee the status of a hypothetical judgment creditor, Section 67 of the Act prohibits the trustee from invoking that status to invalidate a statutory lien for taxes, even though notice of the lien was filed after bankruptcy.

Further support for the conclusion that a trustee is not a "judgment creditor" under Section 6323(a) of the 1954 Code may be found in Section 67 of the Bankruptcy Act. Section 67b specifically recognizes the validity of a federal tax lien as against a trustee in bankruptcy. It provides that even if a federal or state tax lien arises but is not perfected before bankruptcy, the lien nevertheless may be valid if perfected within the time permitted by, and in accordance with, the statute creating the

"Recently legislation has been introduced to amend Section 6323 to expand the group of persons entitled to rely on a filed notice of a tax lien. See H.R. 7914, H.R. 7915, H.R. 9408, and S. 2906, 86th Cong., 1st Sess.; H.R. 4319 and H.R. 4320, 87th Cong., 1st Sess.

lien." As the draftsmen of this provision stated: "This subdivision has two purposes: first, to protect liens of the nature recited * * *; and secondly, to permit such liens to be perfected after bankruptcy, if the time allowed by law for such perfecting has not expired." Analysis of H.R. 12889, 74th Cong., 2d Sess., p. 211; see 4 Collier, *Bankruptcy*, par. 67.20, p. 183 (14th ed.).

Under Section 6323 of the 1954 Code (App., *infra*, p. 42), the tax lien imposed by Section 6321 of the 1954 Code arises at the time the assessment is made. The lien is not perfected, however, until demand for payment has been made. Nor can there be any filing of notice of the lien until after the demand for payment has been made. If, under Section 67b, a federal tax lien, which arises but is unperfected prior to bankruptcy, may be perfected after the petition for bankruptcy has been filed and still be valid as against the trustee in bankruptcy (see *Macatee, Inc.* v. *United States*, 214 F. 2d 717 (C.A. 5)), surely, a tax lien, as in the *Simonson* case, which arose and was perfected prior to the filing of the petition in bankruptcy, must be considered valid under Section 70c, as against the trustee, even though notice of the lien was not filed until after the petition in bankruptcy was filed.

Moreover, Section 67c, which imposes certain limitations on statutory tax liens, does not in any way

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"The pertinent language of Section 67b is as follows: "Where by such laws [which create the statutory liens] such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws * * *."

invalidate a federal tax lien as against the trustee. As originally enacted in 1898, the Bankruptcy Act contained no provision specifically limiting the rights of statutory lienholders to recover on their liens. Although, in 1938, the Chandler Act added provisions to govern statutory liens, none of the newly added provisions vested the trustee with the status of a judgment creditor with respect to a federal tax lien (see *supra*, pp. 22–25). Thus, the Chandler Act amended Section 67c to postpone to a limited degree the payment of stautory liens on personal property not accompanied by possession, but the amendment did not invalidate tax liens. By the Act of July 7, 1952, Sec. 21(d), c. 579, 66 Stat. 420, Section 67c was further amended to invalidate statutory liens arising under state or local law for debts on personal property not reduced to possession, but the 1952 amendment likewise did not affect the continued validity of statutory liens for taxes and debts owing to the United States or for taxes owing to a state or a subdivision.

Thus, by virtue of the express provisions of Section 67 of the Bankruptcy Act and the judicial interpretation of Section 6323(a) of the 1954 Code, Section 70c must be interpreted as not according to the trustee the status of a hypothetical judgment creditor to enable him to oppose statutory liens for taxes, but as according him that status to oppose only contractual liens and liens obtained by legal and equitable proceedings which would have been void or voidable under state law by a creditor in the absence of bankruptcy.[27]

[27] Prior to 1910, the Bankruptcy Act vested in the trustee no better right or title to the bankrupt's property than that which

CONCLUSION

For the foregoing reasons, the decision of the court of appeals (1) allowing payment of the amount of penalties included in the federal tax liens in both cases, and (2) holding that the tax lien in *Simonson* is valid as against the trustee, is correct and should be affirmed by this Court.

Respectfully submitted.

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had belonged to the bankrupt or which the bankrupt's existing creditors actually had acquired at the time the trustee's title vested. See, *e.g.*, *York Manufacturing Co.* v. *Cassell*, 201 U.S. 344, 352 (involving a state contractual lien). When Congress amended Section 47(a)(2) of the Bankruptcy Act (Act of June 25, 1910, c. 412, 36 Stat. 838, Sec. 8), which was the forerunner of Section 70c, it indicated in its committee reports that it had been concerned with the situation created by the *York* case. See S. Rep. No. 691, 61st Cong., 2d Sess., pp. 6–7; H. Rep. No. 511, 61st Cong., 2d Sess., pp. 6–7. Section 70c has been interpreted to vest the trustee with rights to invalidate only state contractual and judicial liens. See, *e.g.*, 4 Collier, *Bankruptcy*, pars. 70.47–70.48 (14th ed., 1959 rev.). In fact, when Section 70c is read in conjunction with Section 67b, which specifically preserves statutory liens, it is reasonable to conclude that Section 70c was not intended to give the trustee the right to invalidate liens created and protected by statute.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 6321. LIEN FOR TAXES.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

SEC. 6322. PERIOD OF LIEN.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

SEC. 6323. VALIDITY AGAINST MORTGAGEES, PLEDGEES, PURCHASERS, AND JUDGMENT CREDITORS.

(a) *Invalidity of Lien Without Notice.*—Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate—

(1) *Under state or territorial laws.*—In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) *With clerk of district court.*—In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) *With clerk of district court for District of Columbia.*—In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

* * * * *

(d) *Disclosure of Amount of Outstanding Lien.*—If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

Bankruptcy Act, c. 541, 30 Stat. 544:

SEC. 2 [As amended by Sec. 1, Act of June 22, 1938, c. 575, 52 Stat. 840]. CREATION OF COURTS OF BANKRUPTCY AND THEIR JURISDICTION.—a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

* * * * *

(20) Exercise ancillary jurisdiction over persons or property within their respective territorial limits in aid of a receiver or trustee ap-

pointed in any bankruptcy proceedings pending in any other court of bankruptcy: *Provided, however,* That the jurisdiction of the ancillary court over a bankrupt's property which it takes into its custody shall not extend beyond preserving such property and, where necessary, conducting the business of the bankrupt, and reducing the property to money, paying therefrom such liens as the court shall find valid and the expenses of ancillary administration, and transmitting the property or its proceeds to the court of primary jurisdiction * * *.

* * * * *

(11 U.S.C. 11.)

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * *

j [As amended by Sec. 14(a), Act of July 7, 1952, c. 579, 66 Stat. 420]. Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss according to law.

* * * * *

(11 U.S.C. 93.)

SEC. 64 [As amended by Sec. 1, Act of June 22, 1938, *supra*, and Sec. 19(a), Act of July 7, 1952, *supra*]. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; * * * (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the

proceeding, * * * (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, * * * the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

* * * * *

(11 U.S.C. 104).

SEC. 67 [As amended by Sec. 1, Act of June 22, 1938, *supra*, and Sec. 21(c) and (d), Act of July 7, 1952, *supra*]. LIENS AND FRAUDULENT TRANSFERS.— * * *

b. The provisions of section 60 of this Act to the contrary notwithstanding, statutory liens in favor of employees, contractors, mechanics, landlords, or other classes of persons, and statutory liens for taxes and debts owing to the United States or to any State or any subdivi-

sion thereof, created or recognized by the laws of the United States or of any State, may be valid against the trustee, even though arising or perfected while the debtor is insolvent and within four months prior to the filing of the petition initiating a proceeding under this Act by or against him. Where by such laws such liens are required to be perfected and arise but are not perfected before bankruptcy, they may nevertheless be valid, if perfected within the time permitted by and in accordance with the requirements of such laws, except that if such laws require the liens to be perfected by the seizure of property, they shall instead be perfected by filing notice thereof with the court.

c. Where not enforced by sale before the filing of a petition initiating a proceeding under this Act, and except where the estate of the bankrupt is solvent: (1) though valid against the trustee under subdivision b of this section, statutory liens, including liens for taxes or debts owing to the United States or to any State or any subdivision thereof, on personal property not accompanied by possession of such property, and liens, whether statutory or not, of distress for rent shall be postponed in payment to the debts specified in clauses (1) and (2) of subdivision a of section 64 of this Act and such liens for wages or for rent shall be restricted in the amount of their payment to the same extent as provided for wages and rent respectively in subdivision a of section 64 of this Act; and (2) the provisions of subdivision b of this section to the contrary notwithstanding, statutory liens created or recognized by the laws of any State for debts owing to any person, including any State or any subdivision thereof, on personal property not accompanied by possession of, or by levy upon or by sequestration or distraint of, such prop-

erty, shall not be valid against the trustee: *Provided, however,* That so much of clause (1) of this subdivision c as restricts liens for wages and rent and clause (2) of this subdivision c shall not apply in proceedings under chapter X of this Act, unless an order shall be entered therein directing that bankruptcy be proceeded with, or in proceedings under section 77 of this Act. The court may on due notice order so much of any lien in excess of the restricted amount under clause (1) and any lien invalid under clause (2) of this subdivision c to be preserved for the benefit of the estate and, in any such event, such lien for the excess and such invalid lien, as the case may be, shall pass to the trustee.

* * * * *

(11 U.S.C. 107.)

SEC. 70 [As amended by Sec. 23 (a) and (e), Act of July 7, 1952, *supra*]. TITLE TO PROPERTY.

a. The trustee of the estate of a bankrupt and his successor or successors, if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition initiating a proceeding under this Act, except insofar as it is to property which is held to be exempt, to all of the following kinds of property wherever located * * *

* * * * *

c. The trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the

bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

* * * * *

(11 U.S.C. 110.)

U.S. GOVERNMENT PRINTING OFFICE: 1938